Financial Markets

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Irving Trust

Irving Trust Company
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New York, NY 10015

Economic Research &
Planning Division

Friday
(Noon)

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Last week in this letter you read that the prime rate would not be raised soon. That forecast was obviously wrong, but subsequent events have shown that at least some market participants endorsed its logic. As noted last week, prime formulas would have called for the prime to rise (and from that perspective the rate increase was a nonevent). Yet the reluctance of banks to ride a narrow cost-of-funds spread to prime sent ominous impulses through the markets concerning the short-term outlook for interest rates. This was indeed one of those rare times when a prime rate increase had an implication for the rest of the money markets.

That implication did not follow as much from a new reading of the banks' implicit outlook for interest rates as it did from the new environment faced by the Fed. The prime rate increase fueled the notion that rates were going up and desensitized the 10% level for Fed funds. This cleared the way for the Fed to let funds trade above 10% and hold to the position that Fed funds were only following market rates. Until the prime rate increase, the Fed was wedged into a corner: It faced election year pressure; the economy was growing quite rapidly; and the Fed funds cap at 10% had been in place for over one year. The Administration had taken the position that the Fed was not tightening, but that the market was. Thus the Fed had to take careful notice of the 10% level for Fed funds; breaching that level would have been a clear signal of a tightening.

Immediately after the prime rate went up, Fed funds rates firmed. The effective Fed funds rates were 10.07%, 10.25%, and 10.36% Monday through Wednesday after the prime rate rose. In response, money market rates rose too; three-month CDs rose about 30 basis points, and six-month instruments rose about 20 basis points over the course of the week. Breaking the 10% level on Fed funds did it, but the prime rate was the key.

Of course other things changed too. The flash forecast showed real GNP growing at a 7.2% rate this quarter, but the strength of the economy has been an ongoing theme in the markets. The event that has been questioned all along has been the Fed's willingness or ability to raise rates. Astounding as it may seem, some analysts have continued to hold that the Fed hasn't tightened, but that it still <u>might</u>. It's true that complicating special factors <u>are</u> affecting the Fed funds rate. Fiscal year-end transactions by Japanese banks, which are prominent players in the dollar markets, affect interest rate movements. The end of the Japanese fiscal year coincides with the end of the first quarter, increasing usual quarter-end pressures in U.S. markets. Also the Fed still seems to be getting adjusted to contemporaneous reserve accounting. Notwithstanding all these factors, the Fed funds rate is higher and the Fed is choosing to not offset the high funds rate. I continue to see the higher funds rate as a policy move. The rise in the prime rate helped to make further increases in Fed funds less of a political problem for the Fed. But we still do not have a clear idea of how high the Fed wants funds.

Robert A. Brusca

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Market Yields

	3/23/84 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.50%	11.00%	10.50%
Effective since	3/19/84		
Discount Rate at Federal Reserve Bank	8.50	8.50	8.50
Federal Funds	10.31	9.25	8.63
Repurchase Agreements	10.00	9.65	8.63
U.S. Treasury Issues			
Bills			
3 months	10.10	9.79	8.82
6 months	10.55	10.17	9.09
1 year	10.87	10.54	9.23
Coupons			
2 years	11.55	11.18	9.85
4 years	11.97	11.72	10.20
7 years	12.35	12.13	10.52
10 years	12.43	12.23	10.57
Long Bond	12.50	12.32	10.61
Negotiable Certificates of Deposit-Secondary Market			
1 month	10.25	9.85	8.85
3 months	10.40	10.05	9.00
6 months	10.65	10.35	9.15
1 year	11.20	10.85	9.45
Banker's Acceptances			
1 month	10.28	9.83	8.85
3 months	10.45	10.07	9.00
6 months	10.75	10.48	9.20
Eurodollar Deposits			
1 month	10.68	10.19	9.38
2 months	10.75	10.31	9.44
3 months	10.81	10.44	9.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	10.21	9.90	8.76
1 month	10.38	10.02	8.94
3 months	10.40	9.97	9.07
Bank Holding Companies			
1 month	9.84	9.33	8.56
Dealer Placed:			
3 months	10.61	10.24	8.98
New AA Corporate Utility Bond	13.60	13.40	12.10
Tax Exempt			
6 month Project Notes	5.95	5.60	4.70
1 year AAA Bond	5.75	5.60	4.85
5 year AAA Bond	7.15	7.00	6.40
20 year AAA Bond	9.55	9.40	8.75

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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